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**WHAT TRIGGERS THE ESTABLISHMENT OF  
A WORKS COUNCIL?**

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# WHAT TRIGGERS THE ESTABLISHMENT OF A WORKS COUNCIL?\*

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## ABSTRACT

This paper presents the first survey evidence about the agent and associated event which triggers the establishment of a works council. We argue that the request of risk protection is a relevant trigger mechanism and show that an organisational shock causes the establishing of a works council. We argue that an organisational shock increases uncertainty of the workforce based on information asymmetries about the security of the workplaces. Furthermore, we show that the workforce alone calls for election in around two third of all cases and in the other third, the management was involved in the establishment. Here, the management values the expected productivity enhancement more than the potential rent redistribution.

JEL Classification: J53, J32, J83, M54

Keywords: co-determination, workers voice, establishment of a works council

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## INTRODUCTION

There is a long tradition of empirical research on effects of works councils (Frege 2002, Addison *et al.* 2004). Most contributions to this tradition analyse effects of existing works councils on firm performance (cf. Addison *et al.* 2004) and wages (cf. Addison *et al.* 2009). These economic outcomes, indeed, may be partly explained by the circumstances of establishment (Addison *et al.* 2004). Events and circumstances triggering the establishment of works councils and the agent who trigger it are important issues given that far from all eligible workplaces have works councils and, once established, voice regimes are difficult to change and managers usually lack the freedom to choose their ideal voice regime (Willman *et al.* 2006). The establishment of works councils changes fundamentally the intra-firm organisation in terms of the legitimacy of management decisions, employee involvement and organisational processes. In spite of the relevance, trigger mechanisms of establishing a works council are not analysed by survey studies so far. However, there are several case studies (for example Mueller-Jentsch 1995, Hall 2006, Schlömer *et al.* 2007) which allow valuable insights but lack on generalization of the findings.

We discuss theoretically relevant trigger events and associated trigger agents. We argue that an analysis of trigger mechanisms for establishing works councils should distinguish between motivation and incentives of the workforce and the management. Both agents are concerned with their rents, but workers are more likely to trigger the establishment if they are interested in enhancing their rent share (rent seeking) or if they fear losing informal rights and rents (rent protection – cf. Jirjahn 2009). First, rent protection or more specifically workers' risk protection is detailed analysed. Here, we argue that in uncovered companies exists an implicit contract between management and workers about fringe benefits, working conditions or even the security of workplaces. When this implicit contract is threatened or even cancelled, workers are willing to raise their voice

in order to establish a works council because workers can not distinguish between a really bad economic situation and a rent redistribution strategy of the management (asymmetric information, cf. Freeman and Lazear 1995). This is empirically shown exploiting an organisational shock. Organisational shocks, such as an outsourcing of a part of the company for example, increase uncertainty basing on information asymmetries about workplace security for the workforce. This uncertainty leads to a desire for legal co-determination representation, which helps the workforce to safeguard its interests. Co-determination based on statutory information and consultation rights differentiates works council from other voice regimes, such as informal worker representation and direct voice practices. Second, we show the association between trigger events and agents. Workforce alone triggers the establishment in around two thirds of all cases and organisational shocks are frequently associated to this agent. On the other side, managers are also involved in approximately one third of all cases in the establishment process and even motivated workers to call for election in a minority of cases. These managers value productivity enhancement more than rent redistribution.

This paper presents the first evidence on trigger events and associated trigger agents for establishing a works council. While Dilger (2003) and Addison *et al.* (2003) estimated the determinants of a newly established works council, they do not specify the trigger agent or event. Contrary, Jirjahn (2009) discusses trigger incentives for the workforce and shows empirically that rent seeking and rent protection are prevalent trigger mechanisms.

The remainder of this paper is structured as follows: first, we present an overview of important institutions, theories about incentives for establishing a works council, and derive our main hypotheses (section 2). Then we describe our data and estimation strategy (section 3). The fourth section presents our results

on trigger agents and trigger events. The last section concludes and discusses generalisation of our results to other countries.

## **INSTITUTIONS, THEORY AND HYPOTHESES**

Works councils' rights are laid down in the Works Constitution Act. Councils shall be elected by the workforces of establishments with five or more employees. Although their creation depends on the initiative of establishment's employees, councils are not present in all eligible establishments (Hübler and Jirjahn 2003). Even if works councils can only be established by the workforce, case studies show that managers also sometimes motivate workers to call for elections, or that management and workforce cooperate for establishing a works council (Schlömer *et al.* 2007). Works councils have full codetermination rights (participation or veto rights) on a set of issues, including introduction of new payment methods, overtime work, and the use of technical devices designed to monitor employee performance. They have weaker consultation rights in matters such as changes in equipment and working methods that affect job requirements. Their information rights cover financial and economic matters (Hübler and Jirjahn 2003).

Theoretically, economic effects of works councils can be analysed using exit voice theories, transaction cost approaches, costs-benefits, and principal agent models. These models typically analyse the outcome of an existing works council and usually distinguish between two effects: productivity enhancement and rent redistribution. We analyse incentives triggering the establishment for management and workforces separately. Management is typically more interested in productivity enhancement, while workforce is more concerned with firm's rent distribution. The establishment can be predicted if expected benefits exceed expected costs for one agent.

Managerial motivation for supporting employee representation has theoretically been analysed by Freeman and Medoff (1984), and adapted to works councils by Freeman and Lazear (1995). The main objective of works councils is to provide workers with voice in order “... to foster labour and management cooperation with the goal of increasing the size of the enterprise ‘pie’. ...” (Freeman and Lazear 1995). Cooperation enables a more effective communication and increases the legitimacy of management decisions, which build trust and mutual understanding (Hall *et al.* 2007). Thus increasing employee commitment and motivation makes workers willing to share their ideas to improve the efficiency of production. Further, increased motivation leads to a reduction in quitting, which implies lower hiring and training costs and less disruption in the functioning of works groups, all of which should increase productivity. In addition, the likelihood that workers and firms remain together for a long period should increase the incentive for investments in skills specific to the enterprise, which also raises productivity (Freeman and Medoff 1984).

On the other hand, employee involvement gives workers a stronger bargaining position to renegotiate firm’s rents. Rents redistribution is the main reason that managers oppose the establishment of a works council, especially when the expected increase of the rent share for the workforce offsets the expected increase in total rent (Freeman and Lazear 1995). Although works councils have no legal right to strike, it can still increase workers’ bargaining power using their veto rights or delaying decisions where participation and consultation rights prevail (Visser 1995). Moreover, management needs more time to prepare for consultations and persuade works councillors (Hall *et al.* 2007). Taken together, this result in our first hypothesis:

*Hypothesis 1 (managerial incentive): In a proportion of cases, management is expected to act as a trigger agent for the establishment of works councils.*

The incentive for workers triggering the establishment is generally considered that works councils are an instrument to renegotiate workers rents. Workers' concerns about the rent share can stem from two different sides: rent seeking and rent protection (cf. Jirjahn 2009). On the one hand, workers can claim a bigger slice of the pie, such that works councils are an instrument to bargain for better working conditions or even force the company to pay higher wages (rent seeking). This incentive is typically considered as workers' primary motivation. On the other hand, the works council can be an instrument to protect quasi rents which workers have created by their effort and human capital investments. Contrary to Jirjahn's terminology, we use risk protection in order to pronounce workers' uncertainty about the future as a relevant trigger.<sup>1</sup> Risk protection can be prevalent, for example, with companies in economic trouble (i.e., where layoffs are imminent or where management changes threaten the cancellation of implicit fringe benefits). In these cases, a works council is an instrument to safeguard workforce interests because works councils have legal access to information on financial and economic matters, as well as legal co-determination rights on personnel issues such as hiring of workers, overtime regulations, lay-offs and social compensation plans. These statutory rights reduce uncertainty and the risk of arbitrary management decisions and give the workforce a voice during the transformation process, which reduce workers uncertainty and fosters trustful employment relations and cooperation (i.e., workers' voice).

We argue that uncovered companies offer an implicit contract including certain compensation schemes, working conditions and fringe benefits in order to attract workers. However, this implicit contract can be threatened when an organisational shock forces managers cancelling fringe benefits or even reducing workplaces. In this situation, workforce can not distinguish if there is really a bad

economic situation or if the management wants to increase their rent share on workers' cost. This information asymmetry is similar to what is described by Freeman and Lazear (1995) and can be overcome by works councils having legal access to information on economic matters and being able to evaluate the economic situation of the company. Establishing a works council reduces information asymmetries and then workers may be willing to accept cancellations, bargaining about alternatives or increase their effort. This results in our second hypothesis:

*Hypothesis 2 (trigger event): An organisational shock increases the workforce's uncertainty, resulting in a higher probability to establish a works council.*

Credible information can be provided by works councils using their statutory information and consultation rights and these statutory rights distinguish works councils from other voice regimes like informal worker representation and direct voice practices.

## **DATA, METHODS AND VARIABLES**

### *Data-Sets*

The empirical analysis is carried out using two datasets, the IAB Establishment Panel and the IfM Bonn Works Council Survey. The IAB Establishment Panel is a representative survey based on stratified random sample—strata for 16 industries and 10 employment size classes—from the population of all German establishments. Although larger plants are over-sampled, sampling is random within each cell (for data description see Kölling 2000). We use the waves 1999-2007 of this

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<sup>1</sup> Risk protection is obviously a subset of rent protection.

panel in which information about works council status, organisational shocks, and other firm characteristics for each company are available. We restrict the sample to profit companies which have established a works council during the last observation period, delete agriculture firms and all companies with more than one change in their works council status and all companies that switch from having to not having a works council. This yields a sample of 316 companies that established a works council between 1999 and 2007. This panel is used to analyse the trigger event of an organisational shock. Organisational shocks are defined as an outsourcing, a spin-off, or a partial plant closure during the last year.

Furthermore, we use the IfM Bonn Works Council Survey for some additional descriptive statistics on the trigger event, the analysis of the trigger agents and correlations between both. The IfM Bonn Works Council Survey is a unique cross-sectional dataset about co-determination in small- and medium-sized companies in Germany. This dataset was collected by the Small and Medium Size Enterprise Research Institute in 2005 (Institut für Mittelstandsforschung - IfM). The survey is representative of companies with 20 to 500 employees and contains 788 establishments (for a detailed data description see Schlömer *et al.* 2007). The unique feature of this survey is a set of questions about the establishment of a works council. All companies covered by a works council report the trigger event, trigger agent, year of establishment, and managerial attitude towards employee representation at the time of establishment. The IfM Bonn Works Council Survey was collected in 2005 several years after most companies established their works councils. Therefore, we drop all companies where the manager reports that he or she cannot remember or was not in charge at the time of establishment. Further, we restrict the sample on companies that established their works council between 2001 and 2005. We draw this sub-sample because these companies also report the number of employees at the time of establishment, which is necessary for our subsequent regression analyses. This yields a

sample of 60 companies that established a works council between 2001 and 2005. Unfortunately, this dataset does not include questions about organisational shocks for firms that did not introduce a works council, and a control group is necessary to estimate the influence of an organisational shock on the probability of establishing one. Therefore, we use the IAB Establishment Panel in order to estimate this causal effect.

### *Empirical Identification*

In order to estimate the effect of an organisational shock on the probability establishing a works council, we use a Probit model as a first benchmark. This model treats every observation of a firm in the panel as independent meaning it does not exploit the panel structure of the data and does not control for unobserved heterogeneity across firms. Examples for unobserved heterogeneity are the cooperative culture, leadership, and innovation pressure facing a firm. The Probit estimation may be for example downward biased when good cooperative culture lead to lower probability of establishing a works council on the one hand and to a lower probability of an organisational shock on the other hand. Therefore, unobserved company fixed effects should incorporate in this framework because workers who unquestionable confide managers have a lower probability of establishing a works council in order to safeguard their interests. Therefore, we prefer the Conditional or Fixed Effect Logit Model in order to control for unobserved heterogeneity and to identify a causal effect. This model uses a within-firm identification strategy and estimates the trigger effect using a subsample of “changers”. This means that all companies that do not change their works council status are not incorporated in the estimation, as intra-firm variability of these companies is zero and they therefore provide no additional explanatory power to the estimation. The model identifies the trigger effect by comparing (or matching) within-establishment variation for each company before and at the time of

establishing a works council. This corresponds to a k to one matching where we compare k periods without a works council with the period of establishing within the same company and estimate the influence of an organisational shock for this transition.

Beside, we use a Probit framework to estimate the correlation between trigger agents and trigger events using the cross-sectional IfM Bonn Works Council Survey.

### *Probability of Establishing*

Establishments of works councils are not frequent. The probability of establishing for a random uncovered company is 1.1 percent according to IAB Establishment Panel during 1999 and 2007. This probability of establishing increases from less than 1 percent in smallest eligible companies up to around 6 percent in companies of around 500 employees (figure A1, appendix). This has to be interpreted that that the probability to be covered is around 5 percent in small companies and less than one percent of these uncovered companies establishing a works council. That is a bigger total number than newly established works councils in companies with 400 to 500 employees where the probability to be covered is around 90 percent (cf. Addison *et al.* 1997, Addison *et al.* 2003). The remaining 10 percent of uncovered companies have a probability of establishing a works council of 6 percent. Summing up, uncovered medium-sized companies have a bigger probability of establishing but a lower total number.

### *Control Variables*

Accordingly, firm size may have a positive influence on establishing a works council. The number of employees indicates a more complex and hierarchical organisation, where councils may mitigate transaction costs. The higher

need of communication increase works council's benefits for management and deepens works councils voice function. Moreover, the legal rights of works councils are stronger in larger firms (Jirjahn 2009) which increases workforces' incentive to call for election. Furthermore, we include several variables for the composition of workforce take into account that different types of workers may differ in their taste for representation. Skilled Workers might be more inclined to raise their voice because their specific human-capital investments may be threatened by a job loss. Whereas works councils may face difficulties in effectively representing part-time employees (Jirjahn and Smith 2006). Further variables which influences the coverage of works councils can also be influences the establishment, for example East-German firms tend to have a lower probability of covering (Zwick 2004). Moreover, we include a dummy for payment above the collective agreement and presence of a collective bargaining agreement. Hübler and Jirjahn (2003) show that collective bargaining coverage may discourage workers from adopting a council because it limits the scope for establishment-level bargaining. Accordingly, companies switching to collective bargaining might discourage workers to establish a works council. Furthermore, export oriented firms, as a common proxy for international competitiveness and firms with higher investments per capita, a common proxy for capital stock which are usually not correlated with works councils (Zwick 2004) but explain organisational shocks (Addison *et al.* 2008). Moreover, other studies found that company strategies such as performance pay, team-work or managerial leadership determines the establishment (Dilger 2003, Addison *et al.* 2003, Jirjahn 2009). All these variables are assumed to be time-constant over the observation period (between 3 and 6 years) and are controlled by our within-firm identification strategy which average out time-constant variables.

## **FINDINGS**

In this section, we will firstly analyse the role of both trigger agents: managerial involvement and workforce alone. This analysis uses the IfM Bonn Works Council Survey which contains detailed information on trigger agents and associated events and enables correlations between both to be examined. Then, we turn to the IAB Establishment Panel for further analysis on the causal impact of organisational shocks on the probability establishing a works council.

### *Trigger agent*

Theoretically, we have argued that both agents, management and workforce, can be interested in establishing a works council. Descriptive statistics about the trigger agent are shown in table 1 basing on the IfM Bonn Works Council Survey subsample of companies that established works councils between 2001 and 2005. The workforce alone triggered the establishment in approximately two thirds of all cases. In the other third, the management was involved in the establishment process. In approximately 7 percent of cases, management itself motivated workers to call for an election. Management motivations for establishing worker representation are described in case studies by Schlömer *et al.* (2007). They describe a manager who knows positive effects of a works council from his previous job, especially the mediation role provided by works councillors, and therefore motivates the workforce to call for election in his new company in order to take advantage of worker representatives.

**Table 1: The Trigger Agent for Establishing a Works Council**

	Observations	Percent
Workforce Alone	37	61.67
Management Involved	19	31.67
Management Motivated	4	6.67

Sample restriction: companies that have established a works council between 2001 and 2005, answers were given by managers; Source: IfM Bonn Works Council Survey 2005.

It is also possible to calculate descriptive statistics on the trigger agent for the entire sample, but these retrospective questions may cause recall problems for respondents and bias the results. For example, it can be shown that the number of firms where managers was involved in the establishment process or motivated the workforce to call for election significantly increases when the time-span between establishment and survey increases. This may be a tribute to good employment relations in these companies, whereby managers cannot imagine opposing employee representation.<sup>2</sup> Nevertheless, we can conclude that workforce alone and workforce in conjunction with management are both prevalent initiators of council establishment which confirms our first hypothesis.

### *Trigger event*

In the second stage of our analysis, we which study event triggers the establishment of a works council (cf. table 2). Contrary to descriptives in table 1, multiple answers per company were possible meaning that some managers identified more than one trigger event. In total, 18 percent of companies established a works council because managers wanted a fixed workers representative and,

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<sup>2</sup> Accordingly, Schlömer *et al.* (2007) cite managers who state, “if works councils do not exist, they have to be invented.”

management wanted to improve motivation and productivity of workers (reason managerial communication). In these cases, the management was involved in the establishment process and almost all management-motivated establishments state these reasons (cf. table 3). Moreover, the itemized answers in table A4 show that managerial involvement takes frequently place as productivity or motivation measure of management. This is a further hint on the managerial motivation supporting the establishment of a works council. These managers may expect that productivity enhancement, because of higher motivation and more efficient communication, offsets the expected costs of potential rent redistribution.

**Table 2: The Trigger Event for Establishing a Works Council<sup>3</sup>**

	Observations	Percent
Organisational Shock	26	35.14
Workers Voice	35	47.30
Managerial Communication	13	17.56

Sample restriction: 60 companies that have established a works council between 2001 and 2005, answers were given by the managers and multiple answers were possible, source: IfM Bonn Works Council Survey 2005. Answers are itemized in appendix table A4.

The second trigger event category is workers' voice, which occurred in approximately one-half of the cases. Workers' voice is defined as conflicts between management and workforce, workers want more co-determination, new workers with experience in employee representation were hired, and manager knows no special reason why workers want a council. Workers' voice trigger events were frequently associated with establishment coming from the workforce alone, as precisely 72 percent of workers' voice trigger events had workforce alone as

<sup>3</sup> The classification in the three groups: managerial communication, workers voice and organisational shock, is based on logical connection due to the fact if management was named in the question or not and if an organisational shock was asked. This classification cannot be obtained by a factor analyses because of 85 percent of the respondents tick only one possible answer and therefore a factor analyses can only be based on a minor sub-sample.

trigger agent (cf. table 3). Third, an organisational shock was specified as trigger event in approximately 35 percent of cases. Organisational shocks are defined as occurrence of a new owner, a partial plant closure, and a radical restructuring of the company. Organisational shocks were strongly associated with the likelihood of workforce alone calling for election (70 percent), but shocks also induced 27 percent of the managerial involvement cases (cf. table 3). In addition, most multiple answers covered an organisational shock, particularly new management together with the voice category that workers wanted more co-determination. This joint occurrence is easily conceivable.

**Table 3: Cross-Tabulation of Trigger Agent and Event Establishing a Works Council**

		trigger event					
		Organisational Shock		Workers Voice		Managerial Communication	
trigger agent	Workforce Alone	18	0.42	25	0.58	0	0.00
		0.70		0.72		0.00	
	Management Involved	7	0.26	10	0.37	10	0.37
		0.27		0.28		0.77	
Management Motivated	1	0.25	0	0.00	3	0.75	
		0.03		0.00		0.23	

The trigger event question allowed for multiple answers; in each cell: top left = the number of cases; top right = the percentages of trigger agents (row); bottom left = the percentages of trigger events (column). Sample restriction: 60 companies that have established a works council between 2001 and 2005. Source: IfM Bonn Works Council Survey 2005.

The descriptive evidence in table 3 suggests that workers alone calls more likely for election if an organisational shock occurred. This is further confirmed by a Probit regression on trigger agents where the likelihood that the workforce alone calls for election is 40 percent higher after controlling for all available

variables at the time of establishing (table 4). The marginal effect of an organisational shock increases up to 48 percent when incorporating managerial attitude towards employee participation at the time of establishment.<sup>4</sup> Positive managerial attitude decreases the probability that workforce alone calls for election, in other words, there management is involved in the establishment process. Managerial attitude is supposed to be obvious or highly endogenous in this context and should cautiously be interpreted. Nevertheless, this underpins the importance of cooperative culture and leadership when evaluating voice regimes (Bryson 2004). These should be incorporated when analysing the establishment of works councils. Moreover, the probability of triggering the establishment by the workforce alone rises in firm size which supports the increasing relevance of voice in bigger and more complex organisations. Other covariates, if the company is branched or located in East Germany have no additionally explanatory power. Moreover, log likelihood significantly decreases when incorporating trigger events variables which shows that events and agents are not randomly correlated to each other.

According to our theoretical explanations, managerial reasons for involvement in the establishment process are typically productivity enhancement and a first attempt to incorporate workers' voice in the company's rent distribution strategy. Contrary, it remains ambiguous whether workers voice categories such as "conflicts between management and workers" results from a risk protection strategy spurred by something like management's plan to cancel fringe benefits or from a rent-seeking strategy. However, an unexpected organisational shock, such as a partial plant closure and outsourcing of part of the company, may clearly signal a risk protection strategy. A shock increases the uncertainty based on information asymmetries and workers may fear losing informal rights, fringe

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<sup>4</sup> We do not include managerial communication in the model because it predicts the failure perfectly (cf. descriptive distribution in table 3).

benefits or even workplaces. This lead to a desire for legal co-determination and representation, both of which helps the workforce safeguards its interests. Therefore, we analyse whether an organisational shock (as a risk protection strategy) triggers the establishment of a works council.

**Table 4: Relation between Trigger Agent and Trigger Event, Marginal Effects after Probit.**

	Coef.	Z-Value	Coef.	Z-Value	Coef.	Z-Value
Dummy: Organisational Shock			0.3913	2.41 **	0.4773	2.66 **
Dummy: Workers Voice			0.5344	3.12 **	0.4384	2.26 **
Managerial Attitude towards Employee Representation					-0.3230	2.97 **
Number of Employees	0.0042	1.74 *	0.0053	2.05 **	0.0040	1.45
Squared Number of Employees/1000	-0.0089	1.60	-0.0114	1.92 *	0.0000	1.13
Dummy: Owner-Manager	0.2742	1.66 *	0.2510	1.36	0.2524	1.29
Dummy: Single Site Company	0.0119	0.08	0.0651	0.38	0.1399	0.78
Dummy: Located in East Germany	0.1809	1.14	0.1594	0.96	0.2467	1.57
Industry Dummies	yes		yes		yes	
Number of Establishments	60		60		60	
LR chi(2)	8.13		20.54		33.57	
Pseudo R <sup>2</sup>	0.1018		0.2571		0.4202	
Log Likelihood	-35.87		-29.66		-23.15	

Dependent Variable: One: Workforce Alone Triggers the Establishment of Works Council, Zero: Managerial Involvement during the Establishing Process.

Sample restriction: companies that established a works council between 2001 and 2005; \*, \*\*, \*\*\* significant on the 10%, 5% or 1% level respectively. Source: IfM Bonn Works Council Survey 2005.

### *The causal effect of an organisational shock*

In order to analyse the causal effect of an organisational shock on establishing of a works council we cannot use the IfM Bonn Works Council Survey because the survey does not provide a sufficient control group, as organisational shocks are not asked in the non-event sample. However, we can use the IAB Establishment Panel in order to identify this trigger event. In the IAB Establishment Panel, an organisational shock is defined as an outsourcing, a spin-off, or a par-

tial plant closure during the last year.<sup>5</sup> The data structure allows the identification of a causal effect of an organisational shock and table 5 shows the Probit as well as the Conditional Logit estimation results for the changers subsample.

**Table 5: Trigger Events for Establishing a Works Council.**

	Conditional Logit				Probit <sup>6</sup>	
	Coef.	Z-Value	Coef.	Z-Value	Coef.	Z-Value
Dummy: Organisational Shock	1.7924	2.04 **	0.8089	2.53 **	0.0591	1.56
Number of Employees	0.0245	2.04 **			0.0006	4.04 ***
Squared Numb. of Employees/1000	-0.0204	1.55			-0.0008	-2.99 ***
<i>Reference Category: Share of Unskilled Workers</i>						
Share of Skilled Workers	0.2418	0.21			0.0100	0.39
Share of Apprentices	6.8585	1.31			0.0130	0.16
Share of Part-Time Workers	-3.6633	2.23 **			-0.0206	-0.71
Export-Share	0.0056	0.31			0.0001	0.38
log(Investments per Capita)	-0.0279	0.41			-0.0036	-2.41 **
Dummy: Collective Bargaining Contract	0.5983	0.97			0.0525	3.84 ***
Dummy: Payment above Collective Agreement Level	0.3745	0.69			0.0214	1.48
Year Dummies	yes				yes	
Industry Dummies	no				yes	
Number of Observations	1262		1262		1262	
LR chi(2)	675.39		6.16		588.68	
Pseudo R <sup>2</sup>	0.8394		0.0077		0.2672	
Log Likelihood	-64.59		-399.21		-520.45	

Dependent Variable: Newly Established Works Council. Probit: marginal effects displayed and standard errors are clustered on companies. Sample restriction: companies that established a works council between 2001 and 2005; \*, \*\*, \*\*\* significant on the 10%, 5% or 1% level respectively. Source: IfM Bonn Works Council Survey 2005.

<sup>5</sup> The responses of the IAB Establishment Panel cover only a part of shock definition of the IfM Bonn Works Council Survey, precisely a partial plant closure and a part of the new owner cases, precisely the outsourcing and spin-offs (confer table A4 in the appendix).

<sup>6</sup> A pure organisational shock in a Probit framework has a significant positive marginal effect of around 14.77 percent (z-Value 2.29).

The Conditional Logit Model confirms our hypothesis that an organisational shock during the last year leads to a higher probability of establishing a works council, which supports the idea that risk protection motivates such establishments.<sup>7</sup> The unconditional probability that an organisational shock occur is 64 percent higher before establishment than in any other years (cf. table A1 and A2). Since organisational shocks are strongly correlated with the trigger agent workforce alone (see table 3), the dummy can be interpreted that an organisational shock increases uncertainty about the security of workplaces, implicit working conditions, and fringe benefits, to name a few. The workforce is willing to establish a works council because they cannot distinguish between a really bad economic situation and managerial rent redistribution on workers costs. A works council can overcome this information asymmetry because it provides statutory information and co-determination rights, in order to safeguard workers interests.

The firm size has also a significant positive impact on the probability of establishing a works council. This corresponds to the unconditional graph in figure A1 meaning that establishing a works council is more likely in more complex organisations proxied by firm size. Additionally, the probability to establish a works council decreases if the share of part-time workers increases. This is in line with Jirjahn and Smith (2006) who states that works councils face difficulties in effectively representing part-time employees. The insignificance of most covariates in the Conditional Logit Model can be explained by the identification strategy. The insignificance means that neither the composition of the workforce nor the coverage of a collective bargaining contract, export-share, investments per capita nor payment above the collective agreement level fundamentally changes at the time of establishment of a works council within one company. This can be due to either employment protection or long-term delivery contracts.

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<sup>7</sup> We display coefficients of the Conditional Logit Model because calculation of marginal effects is only possible under the assumption that the fixed effects are zero for all establishments which contradicts

The identification and interpretation differ slightly in the Probit model. Here, we identify an organisational shock by comparing the year of newly established works council with all other observations without works councils in the treatment group. This model treats all observations for each company as independent, and does not control for unobserved heterogeneity (though standard errors are clustered by company). The model does not support our hypothesis that an organisational shock is more likely in the year of works council's establishment than in any other year. Comparing the assumptions of both models, this means that unobserved company fixed effects, such as the leadership, cooperative culture or production methods (teamwork, performance pay) influences either the probability of an organisational shock as well as the probability of establishing a works council. We argue that unobserved company fixed effects are an important determinant of the establishment probability and therefore the point estimates of the Probit are biased. Nevertheless, just as in the Conditional Logit Model, most covariates have no influence on the probability of establishment. In other words, they do not differ significantly in the year of establishment, but companies seem to invest less and changes more likely to a collective agreement in the year of establishment.

In order to check the robustness of our results, we also calculated everything in deviations from sector means, incorporating only companies observed at least three and four time-periods. All results were very similar to those presented above and we therefore do not display them separately here.

## **CONCLUSION AND DISCUSSION**

This paper presents the first survey evidence for trigger events and associated agents of establishing a works council. First, we focus our analyses on triggering

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our assumptions stated above.

events on risk protection. We argue that a company offers an implicit contract about working conditions and compensation schemes for example. An implicit contract can be threatened when an organisational shock such as outsourcing or a partial plant closure occurs and management have to cancel fringe benefits or even have to reduce workplaces. In this situation, the workforce can not distinguish if there is really a bad economic situation or if the management only wants to increase their rent share on workers cost. Accordingly, risk protection based on this information asymmetry can trigger the establishment of a works council as a legal co-determining representative which helps workers to safeguard its interests. Empirically, we have shown that an organisational shock is a prevalent trigger of establishing a works council. Besides, we show an increasing probability of establishing a works council for bigger uncovered companies.

Moreover, we show that workforce alone is the most frequent trigger agent in around two thirds of all cases, but the management is involved in the other third and even motivated workers to call for election in a minority of cases. Managerial motivation are mostly their expectation that productivity enhancement of works councils outweigh rent redistribution. On the other side, workforce motivations triggering the establishment alone are voice reasons such as conflicts with the management and organisational shocks such as partial plant closure and appointing new managers for example. Then we show that works councils are more frequently established by workforce alone on voice reasons or when an organisational shock occurs.

The organisational shock, however, has a very narrow definition in the IAB Establishment Panel. Theoretically, risk protection comprises more than just organisational shocks due to outsourcing, spin-offs and partial plant closure. Risk protection can also be prevalent in shrinking firms, firms experiencing financial troubles and firms with a new management changing the cooperative culture, there, works council can also reduce workers' uncertainty. In these companies,

management may also be more likely to annul implicit contracts (e.g., seniority wage rules), lay-off tenured workers, enhance the target agreement for workers' performance pay, or cancel fringe benefits. Therefore, the risk protection function of a works council can be defined much more broadly than we are able to address in our regression based on the IAB Establishment Panel. This is why the wider definition of organisational shocks in the IfM Bonn Works Council Survey could lead to a stronger trigger effect of risk protection motivation. Accordingly, Jirjahn (2009) analyse the broader defined relevance of a rent protection strategy and shows that establishing of works councils is correlated with a very poor sales situation, a poor employment growth and a lack of expansive market strategy in the manufacturing sector in Germany (precisely the federal state of Lower Saxony).

Our findings allow some interesting inferences. First, establishing of works councils triggered by uncertainty basing on information asymmetries of workers is based on works councils unique characteristic of statutory information and consultation rights. These rights differentiate works councils from other voice regimes like informal worker representation and direct voice practices. Moreover, risk protection can partly explain the observed pattern of coverage of works councils over firm size where larger companies are more likely to have a works council. Larger companies tend to be older and therefore have had a higher probability to be hit by an organisational shock in the past.

Our findings are also relevant for other countries of the European Economic Area (EEA), which following adoption of the EU's 2002 Information and Consultation of Employees Directive (ICE), are now all required to have provisions for the establishment of representative structures for employee information and consultation within national undertakings i.e. at workplace and/or company level. The rights specified in the Directive differ from the German Works Constitution Act, which provides more robust rights on the timing and quality of information

provision, a more rigorous definition of consultation and, in addition, co-determination rights on a range of issues which in effect provide works councils with veto rights on personnel matters. These differences are likely to dilute the extent of the risk protection provided by national legislation introduced under the Directive as compared to Germany, and hence the incentive for workforces to seek the establishment of works council-type arrangements. Moreover, the Directive also provides considerable leeway for individual member states in framing their implementing national legislation (Carley and Hall 2008).

How far the findings of the present study are relevant to other EEA countries can be considered along two dimensions. The first is the robustness of information and consultation rights. Under Austrian and Dutch legislation, for example, these are equivalent to those specified in Germany. The same broadly applies to the rights of local trade organisations within companies under the basic agreements which govern industrial relations in the Nordic countries. In France and Spain, however, statutory consultation rights are weaker than in Germany – hence the rent protection incentive for workforce is reduced. In the UK and Ireland, where universal rights to employee information and consultation were unknown until the coming into force of national legislation implementing the EU directive (Hall 2006), the recent legislation’s information rights are less precisely specified than in continental Western and Nordic Europe and consultation rights are weaker. Moreover, framing of the UK regulations leaves open the possibility for management and workforce representatives to negotiate ‘private’ arrangements outside of the formal procedures of the UK legislation. These so-called ‘pre-existing’ agreements (Hall, 2006) do not necessarily have to meet the information and consultation standards specified in the UK legislation. Nonetheless, even in the UK and Ireland, the weaker consultation rights do not necessarily impinge on the potential for obtaining credible information about economic situation which are necessary to overcome the information asymmetries after an

organisational shock. Therefore, a works council basing on the ICE Directive can also be an instrument for risk protection, for example, when the management cancel implicit contracts about fringe benefits or working conditions. Indeed, weaker co-determination rights may result in a weaker incentive for workforces to trigger the establishment of a works council. In other countries, management might be a relatively more prominent trigger agent in establishing a works council (cf. Hall *et al.* 2007 for the UK). Management incentives for promoting the establishment of works council-type arrangements are likely to be less impacted by these differences. Hence, in countries such as the UK and Ireland, management appears to be a relatively more prominent trigger agent (Hall *et al.* 2007).

The second dimension is the extent to which rights to information and consultation, and the corresponding works council-type structures, are well established and hence the likely costs and benefits well known to management and workers. In countries such as Germany, where the current legal framework has essentially been in place for more than half a century, then an equilibrium situation prevails. In contrast, where information and consultation rights have only recently been introduced, as in the UK, and a situation of transition prevails, both management and workforces have greater uncertainty about the potential costs and benefits involved. Equilibrium means here especially that, on the one hand, workers and managers are aware of works councils' statutory rights. These rights are taught in Germany, for example, during the apprenticeship where two thirds of a birth cohort is trained. On the other, unions see works councils as a complementary industrial relation institution in Germany and this mutual recognition evolved over a long period accompanied by a intensive conflict (Mueller-Jentsch 1995). Nevertheless, the role of works councils in a historic developed country specific system of industrial relations is hard to predict and therefore country specific institutions do not allow a direct application of our results.

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## APPENDIX

**Table A1: Descriptive Statistics for the Estimation Sample of the IAB Establishment Panel.**

	Mean	St.Dev.	Min.	Max.
<i>Dependent Variables:</i>				
Dummy: Newly Estab. Works Council	0.2504	0.4334	0	1
Dummy: Organisational Shock	0.0404	0.1970	0	1
<i>Employees Characteristics:</i>				
Share of Unskilled Workers	0.2202	0.2800	0	1
Share of Apprentices	0.0509	0.0830	0	0.7634
Share of Skilled Workers	0.7289	0.2760	0	1
Share of Part-Time Workers	0.1711	0.2386	0	1
<i>Establishment Characteristics:</i>				
Number of Employees	64.08	92.45	1	817
Squared Number of Employees /1000	12.65	46.15	0.001	667.5
Dummy: Collective Bargaining Contract	0.4984	0.5002	0	1
Dummy: Payment above the Collective Agreement	0.3415	0.4744	0	1
Export-Share	5.47	15.69	0	100
log(Investments per Capita)	5.48	3.86	0	12.83
<i>Distribution of Industry:</i>				
Cloth and Food Industry	0.0317	0.1753	0	1
Timber Industry	0.0515	0.2211	0	1
Chemical Industry	0.0444	0.2060	0	1
Metal Working Industry	0.0483	0.2146	0	1
Automotive Engineering	0.0594	0.2365	0	1
Electrical Industry	0.0515	0.2211	0	1
Construction	0.1094	0.3122	0	1
Wholesale and Retail	0.1878	0.3907	0	1
Logistic and Telecommunication	0.0555	0.2290	0	1
Services for Companies	0.1450	0.3522	0	1
Research and IT	0.0380	0.1914	0	1
Services for Households	0.1046	0.3062	0	1
Healthcare and Education	0.0729	0.2601	0	1
Number of Establishments	1262			

**Table A2: Descriptive Statistics for Companies with newly Established Works Council in the IAB Establishment Panel.**

	Mean	St.Dev.	Min.	Max.
<i>Dependent Variables:</i>				
Dummy: Newly Established Works Council	1.0000	0.0000	1	1
Dummy: Organisational Shock	0.0633	0.2439	0	1
<i>Employees Characteristics:</i>				
Share of Unskilled Workers	0.2131	0.2709	0	1
Share of Apprentices	0.0521	0.0767	0	0.5152
Share of Skilled Workers	0.7348	0.2693	0	1
Share of Part-Time Workers	0.1742	0.2354	0	1
<i>Establishment Characteristics:</i>				
Number of Employees	81.59	109.85	5	817
Squared Number of Employees /1000	18.69	62.08	0.025	667.5
Dummy: Collective Bargaining Contract	0.5601	0.4972	0	1
Dummy: Payment above the Collective Agreement	0.3703	0.4836	0	1
Export-Share	7.01	17.77	0	100
log(Investments per Capita)	4.86	4.04	0	12.83
<i>Distribution of Industry:</i>				
Cloth and Food Industry	0.0285	0.1666	0	1
Timber Industry	0.0506	0.2196	0	1
Chemical Industry	0.0538	0.2260	0	1
Metal Working Industry	0.0570	0.2321	0	1
Automotive Engineering	0.0791	0.2703	0	1
Electrical Industry	0.0538	0.2260	0	1
Construction	0.0823	0.2752	0	1
Wholesale and Retail	0.1994	0.4002	0	1
Logistic and Telecommunication	0.0506	0.2196	0	1
Services for Companies	0.1361	0.3434	0	1
Research and IT	0.0411	0.1989	0	1
Services for Households	0.0791	0.2703	0	1
Healthcare and Education	0.0886	0.2846	0	1
Number of Establishments	316			

**Table A3: Descriptive Statistics for Companies with newly Established Works Council in the IfM Bonn Works Council Survey (estimation sample at once).**

	Mean	SD	Min	Max
<i>Dependent Variables:</i>				
Dummy: Initiator Workforce Alone	0.6167	0.4903	0	1
Dummy: Initiator Management Involved	0.3833	0.4903	0	1
<i>Trigger Events:</i>				
Workers Voice	0.4333	0.4997	0	1
Organisational Shock	0.5833	0.4916	0	1
Managerial Attitude towards Formal Employee Representation*	3.1166	1.0591	1	5
<i>Company Characteristics:</i>				
Number of Employees	174	119	18.6	440
Squared Number of Employees	44093	50997	346	193600
Dummy: Owner is Manager	0.3333	0.4754	0	1
Dummy: Single Side Company	0.3833	0.4903	0	1
Dummy: Located in East Germany	0.2500	0.4367	0	1
<i>Distribution by Industry:</i>				
Dummy: Manufacturing	0.2000		0	1
Dummy: Construction	0.0833	0.2787	0	1
Dummy: Trade	0.0333	0.1810	0	1
Dummy: Traffic	0.1000	0.3025	0	1
Dummy: Service for Companies	0.4833	0.5039	0	1
Dummy: Service for Households	0.1000	0.3025	0	1
Number of Observations	60			

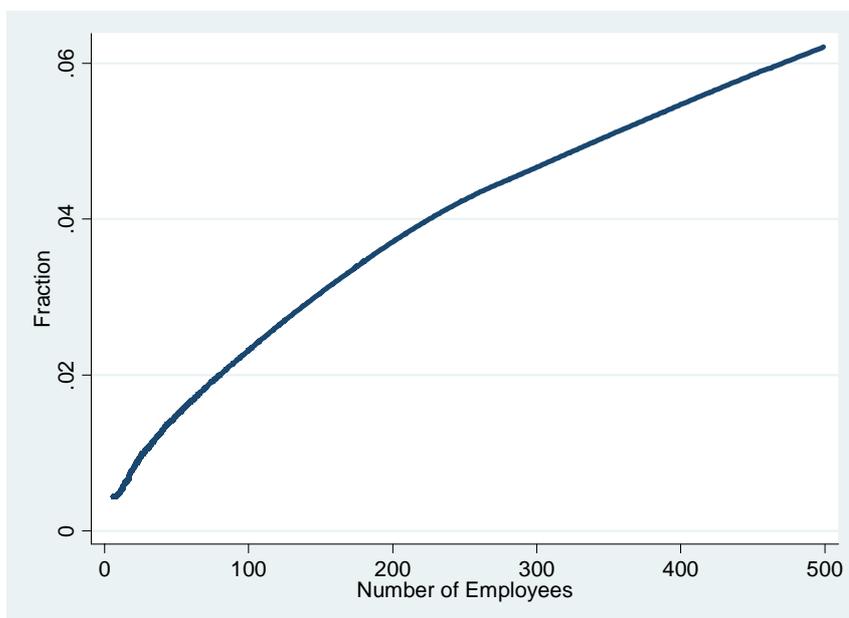
\* Scale from 1 (very negative attitude) to 5 (very positive attitude).

**Table A4: Itemized Answers of Trigger Event to Establish a Works Council**

	Total Ob- servations	Workforce Alone	Management Motivated	Management Involved
New Owner	19	14	0	5
Partial Plant Closure	2	2	0	0
Radical Restructuring	9	6	1	2
To Improve the Productivity	8	0	1	7
To Improve the Motivation	3	0	0	3
Need a Fixed Representative	8	0	2	6
New Workers with Works Council Experience	8	7	0	1
Conflicts between Management and the Workforce	6	5	0	1
Workers want More Co- Determination	11	8	0	3
Management Knows no Reason	16	9	0	7

Total numbers and percentages, multiple answers possible, source: IfM Bonn Works Council Survey 2005.

**Figure A1: Newly Established Works Council over Firm Size, Unconditioned Locally Weighted Regression**



Source: IAB Establishment Panel 1999-2007.

Note: The firm-size range is restricted to 500 employees because we observe too few bigger companies which have newly established a works council and therefore this estimator would not appropriate fit the extended firm size range.